Asia Credit Research

OCBC Bank

Ezra Holdings Limited: Credit Update

Tuesday, 02 February 2016

A Sign of Things to Come

- **Environment remains challenging:** For 1QFY2016 (ending November 2015), Ezra Holdings ("Ezra") reported USD152.3mn in revenues from continuing operations, up 18.9% y/y. Revenue was supported by the marine services division (mainly Triyards) generating USD45.4mn more revenue y/y, due to revenue recognized on work done on four liftboats and two support vessels. This helped to offset weakness at the offshore support services segment (mainly EMAS Offshore), which saw revenue decline USD19.3mn y/y due to pressure on charter rates and weak utilization (particularly for PSVs). As mentioned in our previous report[1], with the announcement of the Chiyoda Corp ("Chiyoda") subsea division joint venture, Ezra has re-stated its subsea division results under discontinued operations. Ezra did disclose some subsea division line items however, with the segment's revenue falling 6.5% y/y to USD180.5mn. With upstream O&G activities in a slump due to low energy prices, management has indicated that utilization of the segment's subsea construction assets has also been impacted. Looking forward, the sole bright spark in Ezra's business segments would be the marine services division, with the shipyard reporting ~USD564mn in order backlog. The two other segments will continue to be vulnerable to the weak environment causing lower charter rates as well as utilization.

- **Subsea division losses dominated**: Ezra made an operating loss of USD10.4mn (for continuing operations) driven in part by USD13.9mn in realized hedging losses (these were mainly used to hedge the bonds and perpetual securities redeemed in September 2015). As such, Ezra generated USD17.0mn in net losses from continuing operations (USD77.6mn net profit in 1QFY2015 not strictly comparable due to bargain purchase gain from acquisition of subsidiaries). It is worth noting that weakness in the offshore support services division has resulted in a gross loss during the period. The subsea division saw net losses widened q/q from USD16.7mn to USD36.7mn. Aside from pressures due to the challenging environment, segment earnings were also pressured by costs incurred in returning a leased ship back to its owner as well as lower-than-expected margins in existing projects. As such, Ezra's total net loss was USD53.7mn.

- **Eyes on the cash burn:** Despite the weak bottom line, Ezra was still able to generate USD12.5mn in operating cash flow. During the quarter, the issuer was able to monetize USD62.0mn in receivables while paying down USD53.4mn in payables. Coupled with a capex of USD9.7mn, Ezra actually generated ~USD2.8mn in free cash flow. That said cash balance fell sharply from USD417.8mn (end-FY2015) to USD138.1mn (end-1QFY2016). This was mainly to redeem both a bond issue (SGD225mn) and its perpetual securities (SGD150mn) which totalled USD265.6mn. Looking forward, we expect operating cash flow to be pressured as the environment continued to sour since the end of November 2015. As such, though management has been disciplined with capex, it is possible that Ezra may swing back to negative free cash flow in the near future.

Treasury Advisory

Corporate FX & Structured Products

Tel: 6349-1888 / 1881

Interest Rate Derivatives

Tel: 6349-1899

Investments & Structured Products

Tel: 6349-1886

GT Institutional Sales

Tel: 6349-1810

OCBC Credit Research

Nick Wong Liang Mian, CFA

+65 6530-7348

NickWong@ocbc.com

[1] OCBC Asia Credit - Ezra Credit Update (12 Nov 2015)

- **Credit profile caveats:** As mentioned, Ezra utilized its cash coffers to redeem bonds due in September 2015. In addition, the firm paid down some bank loans. As such, gross borrowings fell from USD1470.2mn to USD1214.8mn q/q. That said, net gearing inched up slightly from 77% (end-FY2015) to 81% (end-1QFY2016), as the redemption of the perpetual security caused total equity to fall. Net debt / EBITDA worsened q/q as well from 13.8x to 16.2x, driven by the decline in earnings. Ceteris paribus, Ezra's credit profile will be pressured by the soft external environment and could continue to deteriorate.

- **Events impacting liquidity:** Our calculation of EBITDA / interest coverage (which does not include Other Income as well as Associate / JV contributions and discontinued operations) has held constant at 1.5x (FY2015: 1.5x). However, if we utilize the EBITDA calculation as required by the covenant, we estimate 1QFY2016 EBITDA to be negative ~USD0.7mn due to the large losses at the subsea division. Currently, Ezra's interest coverage covenant is 1.75x, tested semi-annually. As such, Ezra will have a tough time meeting its interest coverage covenant for 1HFY2016. That said, we recognize that post the completion of the Chiyoda JV, Ezra's income statement would likely be re-stated, with Chiyoda bearing 50% of the losses generated at the subsea division. Still, this is an area of concern for us to monitor. Cash / current borrowings is tight at just 27%. Management has indicated that they have facilities on standby to help refinance the SGD95mn in bonds due on 21/03/16. In addition, Ezra ended the quarter with USD138.1mn in cash. Note as well that the Chiyoda investment would inject USD150mn in proceeds into Ezra.

- **Chiyoda JV closing delayed:** The JV has become increasingly important for Ezra. It was originally supposed to be executed towards the end of 2015. Instead, the JV is now expected to close during 1Q2016. Management has also indicated that plans to conduct a sales and leaseback of the Lewek Constellation have been put on hold as the price was not attractive. This was a concern as the sales and leaseback was a closing condition for the JV. When queried, management indicated that the decision to hold off the sales and leaseback was made between Ezra and Chiyoda, and that the two parties continue to work towards operational integration for the JV.

- **Adjustment of vessel financing:** One area which management has been working on would be amending their vessel financing from amortizing facilities to bullet maturities (at the end of the original 5 year loan tenure). Banks have been willing to make the amendments, in exchange for fees. This provides the management with some breathing room to preserve liquidity and to deploy vessels in contracts that may not originally be viable due to the need to support principal payments. It is the intention of management to change the majority of Ezra's vessel financing to bullet maturities instead. We recognize that this would help Ezra have more operating leeway to navigate the current challenging environment. That said, we are cognizant that principal payment has been delayed to the future, with no certainty that the future environment will be better than the present.

- **Recommendation:** We will continue to hold Ezra's Issuer Profile at **Negative.** The environment remains challenging, with weaker-than-expected performance at the subsea division. The sharp losses at the subsea division have also resulted in essentially zero EBITDA, which would pressure 1HFY2016 interest coverage covenant. In addition, given the increasing importance of the Chiyoda JV, and the current delays to the execution of the JV, we have decided to take the prudent stance and **downgrade the EZRASP'18s from Overweight to Neutral** until more clarity is given. We will retain the EZRASP'16s at Overweight as we believe that Ezra has adequate resources to redeem the bond upon maturity.

Ezra Holdings Ltd

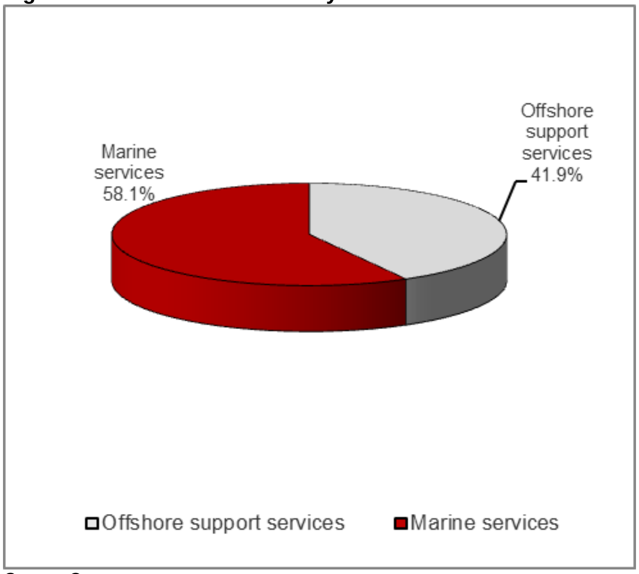
Table 1: Summary financials

Year ended 31st August	FY2014	FY2015	1Q2016
Income statement (US$ mn)		restated	restated
Revenue	1,488.4	543.8	152.3
EBITDA	141.8	76.3	16.7
EBIT	69.6	7.0	-0.9
Gross interest expense	51.3	52.3	11.2
Profit Before Tax	74.7	79.1	-50.7
Net profit	45.3	43.7	-55.3
Balance Sheet (USD'mn)			
Cash and bank deposits	178.9	417.8	138.1
Total assets	3,363.0	4,177.3	3,818.7
Gross debt	1,551.9	1,470.2	1,214.8
Net debt	1,373.0	1,052.3	1,076.7
Shareholders' equity	1,185.8	1,365.3	1,334.4
Total capitalization	2,737.7	2,835.5	2,549.3
Net capitalization	2,558.8	2,417.6	2,411.1
Cash Flow (USD'mn)			
Funds from operations (FFO)	117.4	113.0	-37.8
CFO	140.1	142.5	12.5
Capex	327.4	320.5	9.7
Acquisitions	0.0	-25.2	0.0
Disposals	8.5	30.3	0.0
Dividend	5.4	0.0	0.0
Free Cash Flow (FCF)	-187.3	-178.0	2.8
FCF adjusted	-184.1	-122.5	2.8
Key Ratios			
EBITDA margin (%)	9.5	14.0	10.9
Net margin (%)	3.0	8.0	-36.3
Gross debt to EBITDA (x)	10.9	19.3	18.2
Net debt to EBITDA (x)	9.7	13.8	16.2
Gross Debt to Equity (x)	1.31	1.08	0.91
Net Debt to Equity (x)	1.16	0.77	0.81
Gross debt/total capitalisation (%)	56.7	51.8	47.7
Net debt/net capitalisation (%)	53.7	43.5	44.7
Cash/current borrowings (x)	0.4	0.6	0.3
EBITDA/Total Interest (x)	2.8	1.5	1.5

Source: Company, OCBC estimates

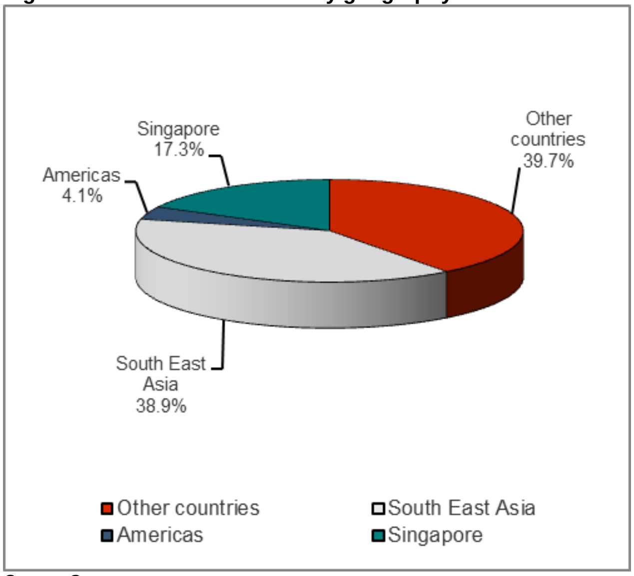
**Adjusted FCF = FCF –Acquisitions – Dividends + Disposals*

Figure 1: Revenue breakdown by business – FY2015



Source: Company

Figure 2: Revenue breakdown by geography – FY2015



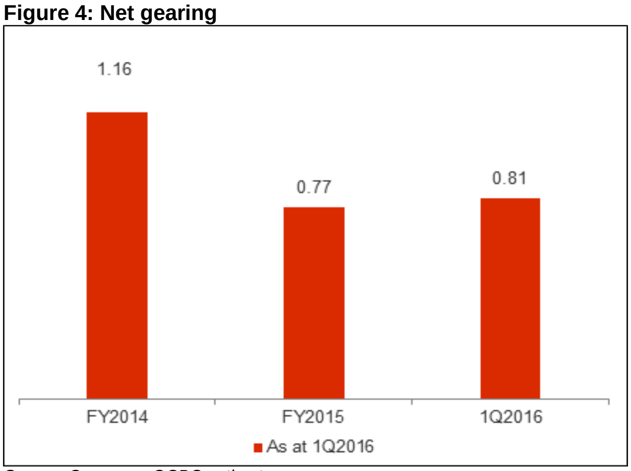
Source: Company

Figure 3: Debt Maturity Profile

Amounts in (USD'mn)	As at 30/11/2015	% of debt
Amount repayable in one year or less, or on demand		
Secured	233.9	19.3%
Unsecured	275.1	22.6%
	509.0	**41.9%**
Amount repayable after a year		
Secured	445.1	36.6%
Unsecured	260.8	21.5%
	705.9	**58.1%**
Total	**1214.8**	**100.0%**

Source: Company

Figure 4: Net gearing



Source: Company, OCBC estimates

Co.Reg.no.:193200032W